NOTICES OF EXEMPT RULEMAKING

The Administrative Procedure Act requires the *Register* publication of the rules adopted by the state's agencies under an exemption from all or part of the Administrative Procedure Act. Some of these rules are exempted by A.R.S. § 41-1005 or 41-1057; other rules are exempted by other statutes; rules of the Corporation Commission are exempt from Attorney General review pursuant to a court decision as determined by the Corporation Commission.

NOTICE OF EXEMPT RULEMAKING

TITLE 14. PUBLIC SERVICE CORPORATIONS; CORPORATIONS AND ASSOCIATIONS; SECURITIES REGULATION

CHAPTER 6. CORPORATION COMMISSION INVESTMENT MANAGEMENT

PREAMBLE

1. **Sections Affected** / **Rulemaking Action**

Sections Affected	Rulemaking Action
Article 1	New Article
R14-6-101	New Section
R14-6-102	New Section
R14-6-103	New Section
R14-6-104	New Section
Article 2	New Article
R14-6-201	New Section
R14-6-202	New Section
R14-6-203	New Section
R14-6-204	New Section
R14-6-205	New Section
R14-6-206	New Section
R14-6-207	New Section
R14-6-208	New Section
R14-6-209	New Section

2. **The specific authority for the rulemaking, including both the authorizing statute (general) and the statutes the rules are implementing (specific):**

   Constitutional authority: Arizona Constitution Article 15 §§ 4, 6, and 13.

   Authorizing statute: A.R.S. § 44-3131

   Implementing statutes: A.R.S. §§ 44-1801, 44-3101, 44-3132, 44-3133, 44-3153, 44-3156, 44-3201, 44-3212, 44-3213, 44-3241, 44-3292, and 44-3296

3. **The effective date of the rules:**

   July 19, 1996

4. **A list of all previous notices appearing in the Register addressing the exempt rules:**

   Notice of Rulemaking Docket Opening:
   1 A.A.R. 172, March 10, 1995

   Notice of Proposed Rulemaking:
   1 A.A.R. 1322, August 11, 1995

   Notice of Supplemental Proposed Rulemaking:
   2 A.A.R. 1597, May 3, 1996.

5. **The name and address of agency personnel with whom persons may communicate regarding the rulemaking:**

Name:	Richard Weinroth, General Counsel
Address:	Corporation Commission, Securities Division 1300 West Washington, Third Floor Phoenix, Arizona 85007
Phone:	(602) 542-4242
Fax Number:	(602) 594-7470

5. **An explanation of the rules, including the agency's reasons for initiating the rules, including the statutory citation to the exemption from the regular rulemaking procedures:**

R14-6-101 through R14-6-209 (the "Investment Adviser Rules") provide a system of regulation which, combined with the enforcement rules (A.A.C. R14-4-301 through R14-4-308, the "Enforcement Rules") under the Arizona Securities Act, A.R.S. ß 44-1801 et seq., establish a comprehensive framework of regulation as authorized by the Arizona Investment Management Act (the "Act") adopted in April 1994. The Act authorized the Arizona Corporation Commission (the "Commission") to adopt rules reasonably necessary to carry out the purposes of the Act. The Commission adopted these rules to accomplish that goal. The rules are as follows:

R14-6-101, Definitions: defines various terms used throughout the rules.

R14-6-102, Scope of Rules: states the legal authority for the rules; provides for the waiver of strict adherence to a rule; and provides that the Commission's Rules of Practice and Procedure apply when not in conflict with the rules.

R14-6-103, Severability: establishes the severability of the rules and the provisions thereof in case any rule or portion thereof is deemed to be invalid.

R14-6-104, Enforcement of the Arizona Investment Management Act: provides that the rules relating to enforcement matters are contained in the Enforcement Rules.

R14-6-201, Books and Records of Investment Advisers: requires investment advisers to comply with the Securities and Exchange Commission's ("SEC") books and records rule; also requires the maintenance of certain additional records in separate files.

R14-6-202, Supervision: provides a safe harbor for investment advisers with respect to their supervisory responsibilities by setting forth procedures that investment advisers can follow to reduce their potential liability for failure to adequately supervise.

R14-6-203, Dishonest and Unethical Practices: provides guidance as to which investment adviser and investment adviser representative practices will be construed to fall within the term "dishonest and unethical" for purposes of A.R.S. § 44-3201(A)(13).

R14-6-204, Written Examination: requires each investment adviser who is a sole proprietor and each investment adviser representative to score at least 70% on the Series 65 or Series 66 examination, and to either complete and maintain 1 of the industry credentials listed in the rule or score at least 70% on the Series 7 or Series 2 examination.

R14-6-205, Information to be Furnished to Clients: requires compliance with the SEC's brochure rule.

R14-6-206, Custody of Client Funds or Securities by Investment Advisers: makes it a fraudulent practice under the Act for an investment adviser to fail to comply with the procedures outlined in the rule when maintaining custody of a client's funds or securities.

R14-6-207, Suitability of Investment Advisory Services: makes it a fraudulent practice under the Act for an investment adviser to fail to provide investment advice consistent with the client's financial situation, investment experience, and investment objectives.

R14-6-208, Advertisements by Investment Advisers or Investment Adviser Representatives: makes it a fraudulent practice under the Act for an investment adviser or investment adviser representative to fail to comply with the limitations on advertising and the requirements outlined in the rule.

R14-6-209, Financial and Disciplinary Information that Investment Advisers Must Disclose to Clients: makes it a fraudulent practice for an investment adviser to fail to disclose to any client or prospective client all material facts with respect to (1) a financial condition that may affect the adviser's ability to meet contractual commitments to clients where the adviser has discretionary authority, custody, or requires prepayments of fees, or (2) a legal or disciplinary event that is material to the evaluation of the adviser's integrity or ability to meet contractual commitments to clients.

The rule is exempt from the Governor's Regulatory Review Council pursuant to A.R.S. § 41-1057. The rule is exempt from Attorney General certification pursuant to the Arizona Constitution Article 15, §§ 4, 6, and 13, and *State ex rel. Corbin v. Arizona Corporation Commission*, 174 Ariz. 216, 848 P.2d 301 (App. 1992).

7. **A showing of good cause why the rules are necessary to promote a statewide interest if the rules will diminish a previous grant of authority of a political subdivision of this state:**

Not applicable.

8. **The summary of the economic, small business and consumer impact:**

The Investment Adviser Rules affect investment advisers and investment adviser representatives that are subject to the Act. In accordance with the intent of the Act, the Investment Adviser Rules set standards of qualification and practice for investment advisers and their representatives. It appears that the compliance efforts required by the Investment Adviser Rules will create some costs for investment advisers and their representatives. For investment advisers that are registered federally or in other states, these costs should be marginal, as those advisers are already complying with substantially similar regulations federally and in other states. For advisers that are not registered elsewhere and will only be subject to regulation in Arizona, the costs may be greater as they will now be required to undertake certain examination requirements and compliance efforts.

The Investment Adviser Rules make no distinction for small investment advisory businesses, as it was the intent of the Act to regulate investment advisers doing business in Arizona, particularly those that are not subject to regulation federally or by other states.

The Investment Adviser Rules should benefit consumers as they provide minimum thresholds of expertise for an investment adviser or investment adviser representative to become licensed. Further, the Investment Adviser Rules require advisers to comply with various disclosure requirements and standards of practice. This should allow consumers to better compare and evaluate an adviser's qualifications and services. Lastly, the Investment Adviser Rules should assist the Commission in combating investment advisory fraud in the State, which will be a great benefit to consumers.

9. <u>A description of the changes between the proposed rules, including supplemental notices and the final rules (if applicable):</u>

There are no differences in the rules as filed in this Notice of Exempt Rulemaking and the Notice of Supplemental Proposed Rulemaking published in the *Register* on May 3, 1996.

The differences between the Notice of Proposed Rulemaking published in the *Register* on August 11, 1995, and this Notice of Exempt Rulemaking are as follows:

R14-6-101: Definitions - This rule was previously numbered R14-6-103. It was renumbered at the suggestion of the Office of the Secretary of State. The rule provides definitions for various terms used in the Rules. Changes were made to the following definitions:

"IM Act" - The reference to the Arizona Revised Statutes was abbreviated to A.R.S.

"Advertisement" - At the suggestion of industry commentators, the definition was amended to specify when a communication over a computer on-line service will not be included in the definition of an advertisement. The changes clarify that electronically-generated communications that are designed by the investment adviser to be accessed by only 1 person will not be included in the definition of "advertisement"; and clarify that non-compensatory discussions on any on-line service will not constitute an advertisement. These changes are found in R14-6-101(B)(2) & (B)(2)(d). Additionally, also at the suggestion of industry, a change was made to subsection (B)(2)(e) to provide that communications by 1 or more investment advisers or investment adviser representatives shall not be deemed an advertisement when they are addressed solely to or are reasonably designed to be accessed solely by other investment advisers or investment adviser representatives.

"Chapter 13" - The reference to the Arizona Revised Statutes was abbreviated to A.R.S.

"Commodity Exchange Act" - This definition was moved from R14-6-209(A)(1) at the suggestion of the Office of the Secretary of State.

"Form ADV" - A reference was added to specify the exact version of the Form ADV that was incorporated, and the fact that it does not include later amendments or editions. This change was made to comply with the Arizona Administrative Procedures Act.

"Rule 204-2" - This definition was moved from R14-6-201(A) at the suggestion of the Office of the Secretary of State.

"Rule 204-3" - This definition was moved from R14-6-205(A) at the suggestion of the Office of the Secretary of State.

"Securities Act" - The reference to the Arizona Revised Statutes was abbreviated to A.R.S.

"Unincorporated organization" - The reference to the Arizona Revised Statutes was abbreviated to A.R.S.

All definitions in the rule were renumbered accordingly.

R14-6-102: Scope of Rules - This rule was previously numbered R14-6-101. Two changes were made to this rule to limit the authority to waive rules to the Commission, and not the Director of the Securities Division.

R14-6-103: Severability - No changes were made to this rule in the Supplemental Notice.

R14-6-104: Enforcement of the Arizona Investment Management Act - No changes were made to this rule in the Supplemental Notice.

R14-6-201: Books and Records of Investment Advisers - Changes were made to clarify that the 5-year period will not be applied retroactively. R14-6-201(C)(4) regarding the maintenance of client acknowledgments pursuant to R14-6-205(B) was deleted because proposed R14-6-205(B) was deleted in the Supplemental Notice. Lastly, a typographical error and cross reference were corrected in R14-6-201(D).

R14-6-202: Supervision - No changes were made to this rule in the Supplemental Notice.

R14-6-203: Dishonest and Unethical Practices - A clarification was made to subsection (10), concerning charging a client an investment advisory fee, because commentators believed that the terms "unreasonable" and "industry standard" were too vague and subjective. The rule was made consistent with Uniform Rule 102(a)(4)-1, subsection (a)(10) of the 1987 North American Securities Administrators Association Rules under the 1956 Uniform Securities Act.

R14-6-203(11)(c) was deleted. The intended purpose of subsection (11)(c) was to deter the practices known as "frontrunning" and "scalping." The Investment Company Institute ("ICI") testified at the public hearing that subsection (11)(c) was unnecessary and ambiguous, and opined that the general provisions of R14-6-203(11) were broad enough to encompass frontrunning and scalping within "dishonest and unethical practices". In addition, the commentator stated that the practice of frontrunning is fraudulent, and actionable under A.R.S. § 44-3241. On that basis, subsection (11)(c) was struck from the rule.

R14-6-203(14) was modified to exclude contracts for impersonal advisory services, making it consistent with the NASAA Model Amendments.

R14-6-203(15) was modified to limit mandatory written disclosures to clients to affirmative answers to disciplinary questions Numbers 11A & 11K in Part I of the Form ADV. This change was made as a compromise between the requirement for an investment adviser to disclose to clients all affirmative responses to the disciplinary questions in Part I of the Form ADV and the deletion of subsection (15) in its entirety. Industry groups were concerned with the burden placed on investment advisers and the non-uniformity of the requirement. Questions 11A (relating to criminal convictions) and 11K (relating to the filing of a bankruptcy petition) in Part I of Form ADV were the 2 questions that most concerned the investor groups and the Securities Division. The fact that investors can request Part I in its entirety from the investment adviser, the Securities Division, or the SEC, together with the affirmative disclosures required by subsection (15) as modified, and by R14-6-209, should provide adequate safeguards for investor protection.

R14-6-203(18) & (19) were deleted. Subsection (18) had required the investment adviser to provide an itemized quarterly account statement to all accounts over which the investment adviser had discretion. Subsection (19) had required the investment adviser to provide an itemized account statement, at least annually, indicating all fees and commissions earned on the account since the last statement. Both provisions were opposed by industry as non-uniform, unduly burdensome, and unnecessary. The Securities Division agreed to the deletion of the provisions because it had proposed subsections (18) & (19) to promote uniformity with federal securities law, but had since been advised informally that the SEC was not proceeding with its rule proposal at this time.

R14-6-204: Written Examination - This rule was amended to limit the authority to designate new examination series numbers and title changes for credentials to the Commission, and not the Director.

R14-6-205: Information to be Furnished to Clients ("Brochure Rule") - Subsection (B) was deleted in response to the concerns of various commentators that the requirement of subsection (B), to disclose in writing to clients the availability of Part I of Form ADV and the nature of the information provided therein, was not consistent with federal and other state rules.

R14-6-206: Custody of Client Funds or Securities by Investment Advisers - Two changes were made to this rule as originally proposed. The rule was amended to change 5 business days to 10 business days in subsection (4). Ten business days was considered a reasonable period of time and 1 that would have no adverse impact on investment advisory clients. Second, several commentators commented on the requirement that an independent CPA verify all client funds and securities. The commentators suggested that the rule be modified to be consistent with the federal regulations which prescribe the use of an "independent public accountant". The Securities Division did not oppose the recommendation and proposed to modify the rule to be consistent with the Uniform Rule 102(e)(1)-1, subsection (a)(6) of the 1987 North American Securities Administrators Association Rules under the 1956 Uniform Securities Act. The Uniform Rule requires annual verification of client funds and securities by either an independent CPA or public accountant. The rule was modified accordingly in subsection (6).

R14-6-207: Suitability of Investment Advisory Services - Non-substantive changes were made to this rule.

R14-6-208: Advertisements by Investment Advisers or Investment Adviser Representatives - Non-substantive changes were made to this rule.

R14-6-209: Financial and Disciplinary Information that Investment Advisers Must Disclose to Clients - Non-substantive changes were made to this rule.

10. <u>A summary of the principal comments and the agency response to them:</u>

No written or oral comments were received regarding the Notice of Supplemental Proposed Rulemaking published in the *Register* on May 3, 1996.

Comment letters were received regarding the Notice of Proposed Rulemaking published in the *Register* on August 11, 1995. The substance of the comments were as follows:

R14-6-101: Definitions - Comments to this rule were made by various commentators regarding the definition of Advertisement. The commentators expressed concern that Internet conversations with more than 1 person would fall within the definition of "advertisement" in (B)(2). They believed that the definition, combined with the requirement of R14-6-201 to maintain an advertising file, would have a chilling effect on the First Amendment rights of an investment adviser who uses the Internet to discuss investment advisory services or related issues. They were also concerned about the compliance burden. In response, the Securities Division proposed 2 changes to the definition of "advertisement." The changes would clarify that electronically-generated communications that are designed by the investment adviser to be accessed by only 1 person will not be included in the definition of "advertisement"; and to clarify that non-compensatory discussions on any on-line service will not constitute an advertisement. These changes are found in R14-6-101(B)(2) & (B)(2)(d). Additionally, 1 industry group expressed concerns about whether communications between investment advisers would fall within the definition of "advertisement." In response, the Securities Division modified the rule to include a new subsection (B)(2)(e) which states that communications by 1 or more investment advisers or investment adviser representatives shall not be deemed an "advertisement" when they are addressed solely to or reasonably designed to be accessed solely by other investment advisers or investment adviser representatives.

R14-6-201: Books and Records of Investment Advisers - One industry group recommended that subsection (B) of the rule be modified to clarify that the 5-year period will not be applied retroactively and to provide a maintenance period for the clients' written acknowledgment. The staff of the Securities Division did not oppose this recommendation.

R14-6-203: Dishonest and Unethical Practices - Several commentators wanted clarification of subsection (10), concerning charging a client an investment advisory fee, because they thought the terms "unreasonable" and "industry standard" were too vague and subjective. One commentator wanted the rules to take the same position as the Securities and Exchange Commission, requiring the disclosure of fees that are in excess of the fee charged by the typical investment adviser for similar services. The Securities Division was not opposed to adding clarifying guidelines to the rule, but did not think that requiring disclosure would resolve the issue. The Securities Division recommended making the rule consistent with Uniform Rule 102(a)(4)-1, subsection (a)(10) of the 1987 North American Securities Administrators Association Rules under the 1956 Uniform Securities Act. Making the proposed rule consistent with the Uniform Rule addressed the issues of vagueness and subjectivity.

One commentator requested clarification of subsection (11)(a). The Securities Division explained that subsection (11)(a) generally provides that it is dishonest and unethical for an investment adviser to fail to disclose to a client, in writing, material conflicts of interest which could be expected to impair the rendering of unbiased and objective advice. This would include the failure to disclose to clients any compensation arrangements connected with the investment advisory services provided to clients which are in addition to the compensation received from such clients for those services. By this subsection, the Securities Division intended to cover all arrangements where an adviser receives compensation from someone other than the client, where such arrangement could affect the rendering of objective advice to the client. The language of subsection (11)(a) is taken verbatim from Uniform Rule 102(a)(4)-1, subsection (a)(11) of the 1987 North American Securities Administrators Association Rules under the 1956 Uniform Securities Act. The Securities Division believed that the rule was clear on its face and is purposefully broad in favor of disclosure. The commentator did not reply to the Securities Division's explanation of the proposed rule.

One commentator raised concerns regarding R14-6-203(11)(c), which provides that it is a dishonest and unethical practice for an investment adviser to fail to "disclose to a client in writing before entering into or renewing an investment advisory agreement with that client, or before any investment advice is rendered, any material conflict of interest relating to the investment adviser, the investment adviser representative, or an employee which could reasonably be expected to impair the rendering of unbiased and objective advice, including but not limited to: . . (c) Undisclosed, conflicting securities positions." The intended purpose of subsection (c) was to deter the practices known as "frontrunning" and "scalping." The commentator testified at hearing that subsection (c) was unnecessary and ambiguous. The commentator opined that the general provisions of Rule 203 are broad enough to encompass frontrunning and scalping within "dishonest and unethical practices." In addition, the commentator stated that the practice of frontrunning is fraudulent, and actionable under A.R.S. § 44-3241. The Securities Division was persuaded that the frontrunning and scalping concerns are sufficiently addressed by A.R.S. § 44-3241 and the general language of Rule 203, and that subsection (c) does not increase investor protection. The Securities Division recommended that subsection (c) be struck from the rule, and the Commission adopted the rule without subsection (c).

One commentator proposed to modify subsection (13) to make it permissible to disclose the identity of clients as long as no disclosure of their affairs or investments was made. The Securities Division was strongly opposed to this modification. It believed that all client information is confidential, including the identity of the client, and if the modification were adopted, then potentially the client's right to confidentiality would be forfeited. Subsection (13) is identical to Uniform Rule 102(a)(4)-1, subsection (a)(14) of the 1987 North American Securities Administrators Association Rules under the 1956 Uniform Securities Act. The subsection was not modified in the final rules.

One commentator proposed that subsection (14) be modified to ensure that the rule, which requires advisers to have written contracts with their clients, excluded contracts pursuant to which the adviser provides impersonal advice, thereby making it consistent with the NASAA Model Amendments. The Securities Division did not oppose this modification.

One commentator recommended that subsection (15) be deleted in its entirety. The commentator noted that pursuant to proposed R14-6-209, as well as Rule 206(4)-4 under the Investment Advisers Act of 1940, an investment adviser has an obligation to disclose any "disciplinary event that is material to an evaluation of the investment adviser's integrity or ability to meet contractual commitments to clients." The commentator questioned the need for subsection (15) because such a disclosure obligation would be imposed upon advisers under Arizona law and is already imposed upon advisers under federal law. The commentator also believed that because the proposed rule fails to include either a materiality standard or a limit upon the time period for which such information must be provided, the rule was overly broad and would result in clients being provided unnecessary and immaterial information. The commentator also pointed out that no other state requires the disclosure that would be required by this subsection. The Securities Division responded that although Part I of the ADV is available from the investment adviser, the Securities Division, or the Securities and Exchange Commission ("SEC"), investors groups such as the American Association of Retired Persons indicated that their constituency often does not know to ask for this information. In its Response to this commentator's comments, the Securities Division stated that it sought to balance the needs of investors to make informed decisions, with the burdens placed on investment advisers. Since the hearing, the Securities Division indicated that it considered the oral testimony of the commentator and has had informal discussions on the issue with the commentator. As a result of those discussions, the Securities Division was not opposed to limiting the application of subsection (15) to those questions in Part I of Form ADV that most concerned the investor groups and the Securities Division: Number 11A (relating to criminal convictions) and Number 11K (relating to the filing of a bankruptcy petition). The Securities Division believed that requiring disclosure of an investment adviser's negative history with regard to either of those 2 issues would resolve most of the substantive concerns voiced by investors. If an affirmative answer to any of the remaining disciplinary questions in Part I of the Form ADV would be material to a client's evaluation and selection of an investment adviser, the Securities Division is of the opinion that disclosure of such a fact would be required pursuant to R14-6-209.

One commentator requested the deletion of subsections (18) and (19). The commentator opposed both provisions as non-uniform, unduly burdensome, and unnecessary. In its Response to the commentator's comments, the Securities Division indicated that it had proposed subsections (18) and (19) to promote uniformity with federal securities law, but that it had since been advised informally that the SEC is not proceeding with its rule proposal at this time. The Securities Division stated that it acknowledged the safeguard under proposed R14-6-206(5) that requires investment advisers who have custody of client funds or securities to send quarterly statements to their clients, and that imposing a similar requirement on investment advisers with discretion may be desirable; however, the Securities Division also acknowledges that prior to imposing a non-uniform requirement, it would be more prudent to determine how the regulations will impact investors and the industry, and to await the outcome of proposed federal regulations. Therefore, the Securities Division was not opposed to the deletion of R14-6-203(18) & (19).

R14-6-204: Written Examination - The Association for Investment Management and Research ("AIMR"), in its written comments, and in its presentation at the hearing, requested that individuals holding the CFA designation be waived from taking the Series 65 exam in addition to the Series 2 or 7 examination requirement. The AIMR presented information which indicated that in order to enter into the CFA program, an individual must have a Bachelor's degree, 3 acceptable character references, and must demonstrate high standards of professional conduct. To achieve the CFA designation, among other requirements, the candidate must have at least 3 years experience in investment management activities and pass the Level I, II, and III examinations administered by AIMR. The Securities Division did not support the requested waiver. The Securities Division commended the AIMR and the CFA's commitment to its educational requirements and to continuing education, but believed that the information tested, especially the ethical requirements, and the format of Series 65 and 66 examinations was sufficiently important to outweigh the burden of the additional testing. The rule was not modified by the Commission.

R14-6-205: Information to be Furnished to Clients ("Brochure Rule") - Several commentators recommended the deletion of subsection (B). They believed that proposed R14-6-203(15), which provides for the disclosure of affirmatively answered disciplinary questions in Part I of the Form ADV was a sufficient requirement to ensure that clients were made aware of the most important disclosures in Part I. Additionally, the commentators were concerned that the requirement of subsection (B) was not consistent with federal and other state rules. In its response, the Securities Division supported the commentators' recommendation. The Securities Division believed that the deletion of subsection (B) would have minimal impact on client protection, as an investment adviser would still have the obligation to disclose disciplinary information to clients under R14-6-203(15).

R14-6-206: Custody of Client Funds or Securities by Investment Advisers - Subsection 4 provides that it is a fraudulent practice for an investment adviser to take or have custody of any securities or funds of any client unless. . "if and when there is a change in the place where or the manner in which the funds or securities are maintained, the investment adviser gives prompt (but in no event more than 5 business days) written notice thereof to the client. . ." One commentator requested that the 5 business days be changed to 10 business days, stating that this was a reasonable period of time and 1 that would have no adverse impact on clients. At the hearing, the Securities Division did not oppose the modification.

Several of the commentators commented on the requirement that an independent CPA verify all client funds and securities. The commentators suggested that the rule be modified to be consistent with the federal regulations which prescribe the use of an "independent public accountant." The Securities Division did not oppose the recommendation and proposed to modify the rule to be consistent with the Uniform Rule 102(e)(1)-1, subsection (a)(6) of the 1987 North American Securities Administrators Association Rules under the 1956 Uniform Securities Act. The Uniform Rule requires annual verification of client funds and securities by either an independent CPA or public accountant.

11. Any other matters prescribed by statute that are applicable to the specific agency or to any specific rule or class of rules:

None.

12. Incorporations by reference and their location in the rules:

Form ADV, the Uniform Application for Investment Adviser Registration [17 CFR 279.1 (1994) (Form amended at 59 FR 21657 (1994) and 59 FR 27659 (1994)] is located in R14-6-101(B)(8), R14-6-203(15), and R14-6-206(1). Securities and Exchange Commission Rule 204-2 (17 CFR 275.204.2 (1994)) is located in R14-6-101(B)(13), and R14-6-201(A), (B), and (D). Securities and Exchange Commission Rule 204-3 [59 FR 21661 (1994) (to be codified at 17 CFR 275.204.3)] is located in R14-6-101(B)(14) and R14-6-205 (A) and (B). Commodity Exchange Act (7 U.S.C. 1 et seq. (1988 & Supp. V 1993)) is located in R14-6-101(B)(5) and R14-6-209(A)(1). The Federal Register (FR) and the Code of Federal Regulations (CFR) are published by the Office of the Federal Register, and are available from the Superintendent of Documents, Government Printing Office, Washington, D.C. 20402. The United States Code (U.S.C.) is published by and available from the Superintendent of Documents, Government Printing Office, Washington, D.C. 20402.

13. Was this rule previously adopted as an emergency rule?

No.

14. The full text of the rules follows:

TITLE 14. PUBLIC SERVICE CORPORATIONS; CORPORATIONS AND ASSOCIATIONS; SECURITIES REGULATION

CHAPTER 6. CORPORATION COMMISSION INVESTMENT MANAGEMENT

ARTICLE 1. GENERAL PROVISIONS RELATING TO THE ARIZONA INVESTMENT MANAGEMENT ACT

ARTICLE 2. DUTIES OF INVESTMENT ADVISERS AND INVESTMENT ADVISER REPRESENTATIVES

ARTICLE 1. GENERAL PROVISIONS RELATING TO THE ARIZONA INVESTMENT MANAGEMENT ACT

R14-6-101. Definitions

A. The definitions set forth in A.R.S. §§ 44-1801 and 44-3101 shall apply to the rules promulgated under Chapter 13.

B. The following definitions shall apply to all rules promulgated under Chapter 13 unless the context otherwise requires:

1. "IM Act" means the Arizona Investment Management Act, A.R.S. § 44-3101 *et seq.*
2. "Advertisement" means, except as set forth in subsections (d) and (e), any notice, circular, letter, or other written, oral, or electronically-generated communication addressed to or reasonably designed by the investment adviser or investment adviser representative to be accessed by more than 1 person, or any notice or other announcement in any publication or by radio or television, which directly or indirectly offers:
   a. Any analysis, report, or publication concerning securities, or which is to be used in making any determination as to when to buy or sell any security, or which security to buy or sell; or
   b. Any graph, chart, formula, or other device to be used in making any determination as to when to buy or sell any security, or which security to buy or sell; or
   c. Any other investment advisory service with regard to securities; or
   d. A communication over a computer on-line service including, but not limited to, an electronic bulletin board shall not be deemed to be an advertisement when an investment adviser or an investment adviser representative is either:
      i. Engaged in a discussion regarding securities and does not receive compensation from any person for the discussion; or
      ii. Responds to unsolicited inquiries regarding the provision of investment advisory services.
   e. A communication by 1 or more investment advisers or investment adviser representatives shall not be deemed to be an Advertisement when the communication is addressed solely to or is reasonably designed to be accessed solely by other investment advisers or investment adviser representatives.
3. "Certified public accountant" or "CPA" means an accountant who has been registered or licensed to practice public accounting and is permitted to use the title "certified public accountant" and use the initials "CPA" after his or her name.
4. "Chapter 13" means A.R.S. Title 44, Chapter 13.
5. "Commodity Exchange Act" means 7 U.S.C. 1 *et seq.* (1988 & Supp. V 1993), which is incorporated by reference, does not contain any later amendments or editions, and is on file in the Office of the Secretary of State. Copies of the Commodity Exchange Act are available from the Securities Division of the Arizona Corporation Commission and from the Superintendent of Documents, Government Printing Office, Washington, D.C. 20402.
6. "Division" means the Securities Division of the Corporation Commission.
7. "Fixed fee basis" means an investment advisory fee which at any given time can be precisely established in dollar amount without regard to the investment performance or value of an account and which is not based on the purchase or sale of specific securities.
8. "Form ADV" means the Uniform Application for Investment Adviser Registration, 17 CFR 279.1 (1994) (Form amended at 59 FR 21657 (1994) and 59 FR 27659 (1994)), which is incorporated by reference, does not contain any later amendments or editions, and is on file in the Office of the Secretary of State. Copies of Form ADV are available from the Division and from the Superintendent of Documents, Government Printing Office, Washington, D.C. 20402.
9. "Impersonal advisory services" means investment advisory services provided solely:
   a. By means of written material or oral statements that do not purport to meet the objectives or needs of specific individuals or accounts;
   b. Through the issuance of statistical information containing no expression of opinion as to the investment merits of a particular security; or
   c. Any combination of the foregoing services.
10. "NASAA" means the North American Securities Administrators Association, Inc. or any successor organization.
11. "NASD" means the National Association of Securities Dealers, Inc. or any successor organization.
12. "Relative" means any relationship by blood, marriage, or adoption, not more remote than 1st cousin.
13. "Rule 204-2" means United States Securities and Exchange Commission Rule 204-2, 17 CFR 275.204.2 (1994), which is incorporated by reference, does not con-

(1994), which is incorporated by reference, does not contain any later amendments or editions, and is on file in the Office of the Secretary of State. Copies of Rule 204-2 are available from the Division and from the Superintendent of Documents, Government Printing Office, Washington, D.C. 20402.

14. "Rule 204-3" means United States Securities and Exchange Commission Rule 204-3, 59 FR 21661 (1994) (to be codified at 17 CFR 275.204.3), which is incorporated by reference, does not contain any later amendments or editions, and is on file in the Office of the Secretary of State. Copies of Rule 204-3 are available from the Division and from the Superintendent of Documents, Government Printing Office, Washington, D.C. 20402.
15. "SEC" means United States Securities and Exchange Commission.
16. "Securities Act" means the Securities Act of Arizona, A.R.S. § 44-1801 *et seq.*
17. "Unincorporated organization" includes a limited liability company for purposes of the definition of "person," as defined in A.R.S. § 44-1801(13).

R14-6-102. Scope of Rules
The following rules are adopted by the Commission under the authority granted pursuant to Chapter 13. All rules shall be generally applicable to the administration of the IM Act but the Commission may at any time abrogate or waive strict adherence to any particular rule in any specific instance where the Commission may deem it advisable for the equitable administration of the law. When not in conflict with these rules, the applicable provisions of A.A.C. R14-3-101 through R14-3-113 also shall apply.

R14-6-103. Severability
The provisions of the rules promulgated under Chapter 13 are severable. If any provision of a rule is held to be invalid, such invalidity shall not affect other provisions which can be given effect without the invalid provision.

R14-6-104. Enforcement of the Arizona Investment Management Act
The rules relating to investigations and examinations conducted pursuant to and orders issued under the IM Act are contained at A.A.C. R14-4-301 through R14-4-308.

ARTICLE 2. DUTIES OF INVESTMENT ADVISERS AND INVESTMENT ADVISER REPRESENTATIVES

R14-6-201. Books and Records of Investment Advisers
A. Each investment adviser shall make, maintain, and preserve books and records in compliance with Rule 204-2. The investment adviser shall concurrently file with the Commission a copy of any notices or written undertakings required to be filed with the SEC under Rule 204-2.
B. To the extent that the SEC amends Rule 204-2, investment advisers in compliance with Rule 204-2 as amended shall not be deemed to be in violation of this Section and shall not be subject to enforcement action by the Commission for violation of this Section to the extent that the violation results solely from the investment adviser's compliance with the amended Rule 204-2.
C. As of the effective date of this Section, each investment adviser shall make, maintain, and preserve for at least 5 years the following additional books and records:
   1. A file containing each customer complaint received relating to advisory activities conducted by the investment adviser, its investment advisory representatives, or its employees, and all correspondence relating to such complaint;
   2. A file containing all advertisements used by the investment adviser or any investment adviser representative, including any radio or television transcripts and advertisements placed on computer or electronic bulletin boards;
   3. In each client file, all correspondence received or sent by the investment adviser, any investment adviser representative, or any employee, that relates to any client account, securities, or funds.
D. Books and records that are required to be maintained pursuant to subsection (A) shall be available for inspection by the Commission in accordance with the provisions of Rule 204-2. Books and records that are required to be maintained pursuant to subsection (C) shall be readily accessible and may be preserved in accordance with Rule 204-2(g).

R14-6-202. Supervision
For purposes of A.R.S. § 44-3201(A)(12), no investment adviser shall be deemed to have failed to reasonably supervise its investment adviser representatives or employees if:
   1. There have been established and maintained written procedures, and a system for applying such procedures, which would reasonably be expected to prevent and detect, insofar as practicable, any violation by such investment adviser representatives or employees of the IM Act, or any rule adopted thereunder; and
   2. Such investment adviser has reasonably discharged the duties and obligations incumbent upon it by reason of such procedures and system without reasonable cause to believe that such procedures and system were not being complied with.

R14-6-203. Dishonest and Unethical Practices
"Dishonest and unethical practices", with respect to investment advisers and investment adviser representatives under A.R.S. § 44-3201(A)(13) shall include, but not be limited to, the following:
   1. Refusing to allow or otherwise impeding designees of the Commission from conducting an investigation or examination under the IM Act or any rule adopted thereunder;
   2. Placing an order to purchase or sell a security for the account of a client without authority to do so;
   3. Placing an order to purchase or sell a security for the account of a client upon instruction of a third party without first obtaining a written 3rd-party trading authorization from the client;
   4. Exercising any discretionary power in placing an order for the purchase or sale of securities for a client without first obtaining written discretionary authority, unless the discretionary power relates solely to the price at which, or the time when, an order involving a definite amount of specified securities shall be executed, or both;
   5. Inducing trading in a client's account that is excessive in size or frequency in view of the financial resources, investment objectives, and character of the account;
   6. Borrowing money or securities from a client or client's account unless the client is a dealer, an affiliate, or relative of the investment adviser or investment adviser representative, or a financial institution or other entity engaged in the business of loaning funds or securities;
   7. Loaning money to a client unless the investment adviser or investment adviser representative is a financial institution or other entity engaged in the business of loaning funds or the client is an affiliate or relative of the investment adviser or investment adviser representative;

8. Misrepresenting to any client, or prospective client, the qualifications of the investment adviser, the investment adviser representative, or an employee, or misrepresenting the nature of the investment advisory services being offered or fees to be charged for such services, or omitting to state a material fact necessary to make the statements made regarding qualifications, services, or fees, in light of the circumstances under which they were made, not misleading;
9. Providing a report or recommendation to any client prepared by someone other than the investment adviser or investment adviser representative without disclosing that fact. This prohibition does not apply to a situation where the investment adviser or investment adviser representative uses published research reports or statistical analyses to render investment advice or where the investment adviser or investment adviser representative orders such a report in the ordinary course of providing service;
10. Charging a client an investment advisory fee that is unreasonable in light of the type of services to be provided, the experience and expertise of the investment adviser or the investment adviser representative, the sophistication and bargaining power of the client, and whether the investment adviser has disclosed that lower fees for comparable services may be available from other sources;
11. Failing to disclose to a client in writing before entering into or renewing an investment advisory agreement with that client, or before any investment advice is rendered, any material conflict of interest relating to the investment adviser, the investment adviser representative, or an employee which could reasonably be expected to impair the rendering of unbiased and objective advice including, but not limited to:
    a. Compensation arrangements connected with investment advisory services to clients which are in addition to compensation from such clients for those services; and
    b. Charging a client an investment advisory fee for rendering investment advice without disclosing that compensation for executing securities transactions pursuant to such investment advice will be received by the investment adviser, the investment adviser representative, or an employee;
12. Promising or guaranteeing a client that a gain, loss, or other outcome will be achieved as a result of the investment advice;
13. Disclosing the identity, affairs, or investments of a client to any 3rd party unless required by law to do so, or unless consented to by the client;
14. With respect to any client initially retained after the effective date of this rule, entering into, extending, modifying, or renewing any investment advisory contract except a contract for impersonal advisory services unless such contract is in writing and discloses all the material terms of the contract including but not limited to the services to be provided, the investment advisory fee or the formula for computing the fee, the amount or the manner of calculation of the amount of the prepaid fee to be returned in the event of contract termination or non-performance, and of any grant of discretionary power to the investment adviser;
15. With respect to any client initially retained after the effective date of this rule, entering into, extending, modifying, or renewing any investment advisory contract without disclosing, in writing to the client, any affirmative answers to disciplinary questions numbered 11A and 11K in Part I of the Form ADV;
16. Entering into, extending, modifying, or renewing any investment advisory contract which allows the assignment of such contract by the investment adviser without the prior written consent of the client;
17. Committing any act that results in denial, revocation, or suspension of a license or registration relating to securities by an agency of any state, where such denial, revocation or suspension arises out of any scheme, act, practice or course of business that operates or would operate as a fraud or deceit, or arises out of a violation of Article 13 of the Securities Act or the rules promulgated thereunder; and
18. For any investment adviser to, in any manner, request, or require, in any contract, agreement, or otherwise, any condition, stipulation, or provision binding on any person to waive compliance with any provision of the IM Act or the rules thereunder. Any such waiver shall be void.

R14-6-204. Written Examination

A. Prior to licensure, except as provided in subsection (B), each investment adviser who is an individual and each investment adviser representative, each of whom is hereafter referred to as an "applicant," must take and receive a score of at least 70% on:
  1. The NASAA Series 65 Uniform Investment Adviser State Law Examination or Series 66 Combined State Law Examination; and
  2. The NASD Series 7 General Securities Registered Representative Examination or Series 2 General Securities Representative (Non-member) Examination.

B. The examinations described in subsection (A)(2) shall not be required of an applicant who has completed and maintains 1 of the following credentials:
  1. Certified Financial Planner (CFP) designation awarded by the Certified Financial Planner Board of Standards, Inc.;
  2. Chartered Financial Analyst (CFA) designation awarded by the Institute of Chartered Financial Analysts;
  3. Chartered Financial Consultant (ChFC) designation awarded by the American College, Bryn Mawr, Pennsylvania;
  4. Chartered Investment Counselor (CIC) designation awarded by the Investment Counsel Association of America, Inc.; or
  5. Personal Financial Specialist (PFS) designation awarded by the American Institute of Certified Public Accountants.

C. In the event that the NASAA or NASD Series examination numbers change, the most current examination series deemed applicable by the Commission to the category of licensure shall apply.

D. In the event that the title changes for any of the credentials designated in subsection (B), the title deemed applicable by the Commission shall apply.

R14-6-205. Information to be Furnished to Clients ("Brochure Rule")

A. Each investment adviser shall comply with the provisions of Rule 204-3.

B. To the extent that the SEC amends Rule 204-3, investment advisers in compliance with Rule 204-3 as amended shall not be deemed to be in violation of this Section and shall not be subject to enforcement action by the Commission for violation of this Section to the extent that the violation results solely from the investment adviser's compliance with the amended Rule 204-3.

R14-6-206. Custody of Client Funds or Securities by Investment Advisers

It shall constitute a fraudulent practice within the meaning of A.R.S. § 44-3241(A)(4) for any investment adviser to take or have custody of any securities or funds of any client unless:

1. The investment adviser notifies the Commission in writing that the investment adviser has or may have custody of client funds or securities. Such notification may be given on Form ADV;
2. The securities of each client are segregated, marked to identify the particular client having the beneficial interest therein, and held in safekeeping in some place reasonably free from risk of destruction or other loss;
3. All client funds are deposited in 1 or more bank or similar accounts containing only clients' funds, such accounts are maintained in the name of the investment adviser as agent or trustee for such clients, and the investment adviser maintains a separate record for each such account showing the name and address of the bank or similar institution where the account is maintained, the dates and amounts of deposits into and withdrawals from the account, and the exact amount of each client's beneficial interest in the account;
4. Immediately after accepting custody or possession of funds or securities from any client, the investment adviser notifies the client in writing of the place where and the manner in which the funds and securities will be maintained and, subsequently, if and when there is a change in the place where or the manner in which the funds or securities are maintained, the investment adviser gives prompt (but in no event more than 10 business days) written notice thereof to the client;
5. At least once every 3 months, the investment adviser sends each client an itemized statement showing the client's funds and securities in the investment adviser's custody at the end of such period and all debits, credits, and transactions in the client's account during such period; and
6. At least once every calendar year, an independent CPA or public accountant verifies all client funds and securities by actual examination at a time chosen by the independent CPA or public accountant without prior notice to the investment adviser. The independent CPA's or public accountant's report stating that such CPA or public accountant has made an examination of such funds and securities, and describing the nature and extent of the examination, shall be filed with the Commission promptly (but in no event more than 30 days) after each such examination.

R14-6-207. Suitability of Investment Advisory Services

It shall constitute a fraudulent practice within the meaning of A.R.S. § 44-3241(A)(4) for any person providing investment advisory services to provide investment advisory services to any client, other than in connection with impersonal advisory services, unless the person:

1. Before providing any investment advisory services, and as appropriate thereafter, makes a reasonable inquiry of the client as to the financial situation, investment experience, and investment objectives of the client; and
2. Reasonably determines that the investment advisory services are suitable for the client based upon the information obtained from the client in accordance with subsection (1) above.

R14-6-208. Advertisements by Investment Advisers or Investment Adviser Representatives

A. It shall constitute a fraudulent practice within the meaning of A.R.S. § 44-3241(A)(4) for any investment adviser or investment adviser representative, directly or indirectly, to use any advertisement:
   1. Which refers, directly or indirectly, to any testimonial of any kind concerning the investment adviser or investment adviser representative or concerning any advice, analysis, report, or other service rendered by such investment adviser; or
   2. Which refers, directly or indirectly, to past specific recommendations of such investment adviser or investment adviser representative which were or would have been profitable to any person; provided, however, that this shall not prohibit an advertisement which sets out or offers to furnish a list of all recommendations made by such investment adviser or investment adviser representative within the immediately preceding period of not less than 1 year if such advertisement, and such list if it is furnished separately:
   a. States the name of each such security recommended, the date and nature of each such recommendation for example, whether to buy, sell or hold), the market price at that time, the price at which the recommendation was to be acted upon, and the market price of each such security as of the most recent practicable date; and
   b. Contains the following cautionary legend on the 1st page thereof in print or type as large as the largest print or type used in the body or text thereof: "It should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities in this list;" or
   3. Which represents, directly or indirectly, that any graph, chart, formula, or other device being offered can in and of itself be used to determine which securities to buy or sell, or when to buy or sell them; or which represents, directly or indirectly, that any graph, chart, formula, or other device being offered will assist any person in making his or her own decisions as to which securities to buy or sell, or when to buy or sell them, without prominently disclosing in such advertisement the limitations thereof and the difficulties with respect to its use; or
   4. Which contains any statement to the effect that any report, analysis, or other service will be furnished free or without charge, unless such report, analysis or other service actually is or will be furnished entirely free and without any condition or obligation, directly or indirectly; or
   5. Which states that the Commission has approved any advertisement.

B. When requested by the Commission, any advertisement used directly or indirectly in connection with the provision of investment advisory services shall be filed with the Commission at least 10 business days prior to its proposed use.

C. Any advertisement that has been requested by the Commission pursuant to the provisions of subsection (B) of this Section but that has not been filed with the Commission shall not be used.

R14-6-209. Financial and Disciplinary Information that Investment Advisers Must Disclose to Clients

A. The following definitions shall apply to this Section:
   1. "Investment-related" means pertaining to securities, commodities, banking, insurance, or real estate (including, but not limited to, acting as or being associated with a broker-dealer, investment company, investment adviser, government securities broker or dealer, municipal securities dealer, bank, savings and loan association, entity, or

person required to be registered under the Commodity Exchange Act, or fiduciary).

2. "Involved" means acting or aiding, abetting, causing, counseling, commanding, inducing, conspiring with, or failing reasonably to supervise another in doing an act.
3. "Management person" means a person with power to exercise, directly or indirectly, a controlling influence over the management or policies of an investment adviser which is a company or to determine the general investment advice given to clients.
4. "Self-regulatory Organization" or "SRO" means any national securities or commodities exchange, registered association, or registered clearing agency.

B. It shall constitute a fraudulent practice within the meaning of A.R.S. § 44-3241(A)(4) for any investment adviser to fail to disclose to any client or prospective client all material facts with respect to:

1. A financial condition of the investment adviser that is reasonably likely to impair the ability of the investment adviser to meet contractual commitments to clients, if the investment adviser has discretionary authority (express or implied) or custody over such client's funds or securities, or requires prepayment of advisory fees of more than 5 hundred dollars from such client, 6 months or more in advance; or
2. A legal or disciplinary event that is material to an evaluation of the investment adviser's integrity or ability to meet contractual commitments to clients.

C. It shall constitute a rebuttable presumption that the following legal or disciplinary events involving the investment adviser or a management person of the investment adviser (any of the foregoing being referred to hereafter as a "person") that were not resolved in the person's favor or subsequently reversed, suspended, or vacated are material within the meaning of subsection (B)(2) for a period of 10 years from the time of the event. No affirmative or negative presumption of materiality shall be created under subsection (B)(2) for events not specifically set forth in this subsection.

1. A criminal or civil action in a court of competent jurisdiction in which the person:
   a. Was convicted, pleaded guilty or nolo contendere ("no contest") to a felony or misdemeanor, or is the named subject of a pending criminal proceeding (any of the foregoing referred to hereafter as "action"), and such action involved: an investment-related business; fraud, false statements, or omissions; wrongful taking of property; or bribery, forgery, counterfeiting, or extortion;
   b. Was found to have been involved in a violation of an investment-related statute, rule, or regulation; or
   c. Was the subject of any order, judgment, or decree permanently or temporarily enjoining the person from, or otherwise limiting the person from, engaging in any investment-related activity.
2. Administrative proceeding before the Securities and Exchange Commission, the Commission, or any federal regulatory agency or any state agency (any of the foregoing being referred to hereafter as "agency") in which the person:
   a. Was found to have caused an investment-related business to lose its authorization to do business; or
   b. Was found to have been involved in a violation of an investment-related statute, rule, or regulation and was the subject of an order by the agency denying, suspending, or revoking the authorization of the person to act in, or barring or suspending the person's association with, an investment-related business; or otherwise significantly limiting the person's investment-related activities.
3. Self-regulatory Organization ("SRO") proceedings in which the person:
   a. Was found to have caused an investment-related business to lose its authorization to do business; or
   b. Was found to have been involved in a violation of the SRO's rules and was the subject of an order by the SRO barring or suspending the person from membership or from association with other members, or expelling the person from membership; fining the person more than $2,500; or otherwise significantly limiting the person's investment-related activities.

D. The information required to be disclosed by subsection (B) shall be disclosed to clients promptly but in no event later than thirty days after the occurrence of the event requiring disclosure, and to prospective clients not less that 48 hours prior to entering into any written or oral investment advisory contract, or no later than the time of entering into such contract if the client has the right to terminate the contract without penalty within 5 business days after entering into the contract.

E. For purposes of calculating the 10-year period during which events are presumed to be material under subsection (C), the date of the reportable event shall be the date on which the final order, judgment, or decree was entered, or the date on which any rights of appeal from preliminary orders, judgments, or decrees lapsed.

F. Compliance with subsection (C) shall not relieve any investment adviser from the disclosure obligations of subsection (B) of the Section; compliance with subsection (B) of the Section shall not relieve any investment adviser from any other disclosure requirement under the Act, the rules thereunder, or under any other state or federal law. Note: Investment advisers may disclose this information to clients and prospective clients in their "brochure," the written disclosure statement to clients under R14-6-205, provided, that the delivery of the brochure satisfies the timing of disclosure requirements described in subsection (D).